

REPORT ON EXAMINATION  
OF  
GREAT LAKES INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2006

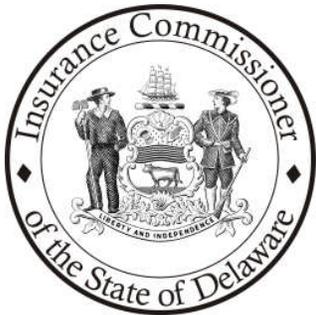
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2006 of the

**GREAT LAKES INSURANCE COMPANY**

is a true and correct copy of the document filed with this Department.

ATTEST BY: *Antoinette Handy*

DATE: 12 MAY 2008



*In Witness Whereof,* I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 12TH DAY OF MAY 2008.

*Matthew Denn*

*Insurance Commissioner*

**REPORT ON EXAMINATION**  
OF THE  
**GREAT LAKES INSURANCE COMPANY**  
AS OF  
**December 31, 2006**

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", written in a cursive style.

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MATTHEW DENN  
INSURANCE COMMISSIONER

DATED this 12TH Day of MAY 2008.

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November 23, 2007

Honorable Mathew Denn  
Insurance Commissioner  
State of Delaware  
841 Silverlake Boulevard  
Dover, Delaware 19904

Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority Number 07-041, an examination has been made of the affairs, financial condition and management of

**Great Lakes Insurance Company**

hereinafter referred to as the "Company" or "GLIC", incorporated under the laws of the State of Delaware. The examination was conducted at the principal offices of the Company, located at 500 Stanton-Christiana Road in Newark, Delaware.

The report of examination thereon is respectfully submitted.

## **SCOPE OF EXAMINATION**

The last examination was conducted as of December 31, 2003 by the Delaware Insurance Department. This examination covers the period of January 1, 2004 through December 31, 2006, and consisted of a general survey of the Company's business policies and practices; management, any corporate matters incident thereto; a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

The format of this report is designed to explain the procedures employed on examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible officials during the course of the examination.

The general procedure of the examination followed the rules established by the National Association of Insurance Commissioners' (NAIC) Financial Examiners Handbook Committee and generally accepted examination standards.

In addition to items hereinafter incorporated as a part of the written report, the following were checked and made a part of the workpapers of this examination:

Corporate Insurance  
Code of Conduct  
All Asset and Liability Items not mentioned

## **HISTORY**

Great Lakes Insurance Company was originally incorporated under the laws of the State of Ohio on December 30, 1950 as the Great Lakes Fire and Marine Insurance Company and commenced operations on January 1, 1953. The present name was adopted in September, 1967.

In November 1967, the Company was acquired by Chemical Financial Credit Corporation (CFCC), an Ohio Corporation, and subsidiary of Chemical Financial Services Corporation, Ltd., a Delaware Corporation. By merger on June 30, 1975, CFCC became a wholly owned subsidiary of the Chemical Banking Corporation.

On March 31, 1996, The Chase Manhattan Corporation merged with and into Chemical Banking Corporation. In connection with the merger, Chase Delaware Insurance Holdings, Inc. was formed on October 16, 1996. Concurrently, Chase Delaware purchased the Company from Chemical Financial Services for an amount equal to book value; which approximated fair value.

The Company re-domiciled from the State of Ohio to Delaware in 1997.

On July, 1999, Chase Holdings, Inc. merged with CBD Holdings, Ltd., with the latter company being the surviving entity. CBD Holdings, Ltd. was the parent of the Company at year end 2006 but merged with J.P. Morgan Insurance Holdings on January 1, 2007.

On December 31, 2000, Chase Manhattan merged with J.P. Morgan. The name of the combined entity became J.P. Morgan Chase & Co.

In 2000, changes in federal banking laws permitted banks to offer directly debt protection products that previously had been underwritten by insurance companies. Starting in 2000, no new business has been assumed by GLIC and its existing business has been run-off.

In 2006, the Company received permission from the Delaware Insurance Department to pay a \$75,000,000 shareholder dividend.

**CAPITALIZATION**

The following changes occurred in the capital accounts since the previous examination as reported in the Company's Annual Statements:

	Common Capital <u>Stock</u>	Gross Paid in And Contribution <u>Surplus</u>	Unassigned <u>Funds</u>	Restricted <u>Surplus</u>	TOTAL
12/31/2003	1,000,000	1,500,000	51,161,325	(64,780)	53,596,545
<b>Net income (loss)</b>			39,415,550		39,415,550
<b>Change in non-admitted</b>			13,006		13,006
<b>Change in Net deferred income tax</b>			(71,425)		(71,425)
<b>Aggregate Write-in; change in surplus</b>			(77,881)	64,780	(13,101)
<b>Dividend to Stockholders</b>			(75,000,000)		(75,000,000)
<b>12/31/2006</b>	<b>1,000,000</b>	<b>1,500,000</b>	<b>15,440,575</b>	<b>0</b>	<b>17,940,575</b>

Note: the above amounts are prior to the Examination Financial Adjustments.

The Company's Certificate of Incorporation authorizes the issuance of 5,000 shares of Common Stock at a par value of \$500 per share. 2,000 shares were issued and held at December 31, 2006 by CBD Holdings, LTD. On January 1, 2007, CBD Holdings, LTD merged with and into J.P. Morgan Insurance Holdings, LLC.

**DIVIDENDS TO STOCKHOLDERS**

There were dividends issued to stockholders during the examination period as follows:

2004-	0
2005-	0
2006 -	\$75,000,000

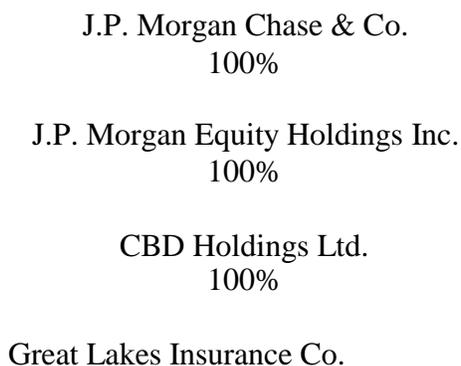
The 2006 extraordinary dividend was approved by the State of Delaware Insurance Department.

**HOLDING COMPANY SYSTEM**

GLIC is a member of an Insurance Holding Company as defined in Section 5001 of the Delaware Insurance Code. Registration statements have been filed with the State of Delaware as required. J.P. Morgan Chase & Co. is named as the ultimate controlling person of the Holding Company System. The year end 2006 financial statements issued by J.P. Morgan Chase & Co. reported the following:

Assets	\$1,351,520,000,000
Total Stockholders Equity	115,790,000,000
For 2006:	
Net Revenue	\$61,437,000,000
Net Income	14,444,000,000

At December 31, 2006, an abbreviated organization chart was as follows:



As noted above, effective January 1, 2007, CBD Holdings Ltd. merged with and into J.P. Morgan Insurance Holdings, LLC.

**MANAGEMENT AND CONTROL**

The affairs of the Company shall be managed by a Board of Directors composed of a minimum number of directors, no less than three (3) members. The Directors are elected by the Shareholders at the annual meeting but need not be Shareholders to be Directors.

The Company's Board of Directors consisted of the following members as of December 31, 2006:

David S. Barrell  
Corrine M. Burger  
Kenneth B. Terwilliger

The following officers were elected and serving as of December 31, 2006:

<b><u>Name</u></b>	<b><u>Office</u></b>
James Harlin	President *
David S. Barrell	Vice President & Treasurer
Arthur T. Guja	Senior Vice President & Secretary
Ronne L. Hoffman	Vice President & Assistant Secretary
Patricia L. Shores	Vice President & Assistant Treasurer

On the 2006 Annual Statement, Corrine M. Burger was reported as the President of GLIC. From a review of the minutes provided by the Company, Ms. Burger wasn't elected until 2007. Furthermore, Paul Petrylak was elected President and a director of GLIC on December 10, 2004 but was not listed as holding those positions on the 2004 Annual Statement.

**It is recommended the Company take greater care in reporting officers and directors on the Company's filed financial statements.**

Section 4919 of the Delaware Insurance Code requires that every domestic insurer promptly notify the Insurance Commissioner of changes in its officers and directors. During the period under examination, the office of President changed twice. The Company did not send timely correspondence notifying the Insurance Commissioner of these changes. As a

result of this violation of Section 4919 of the Delaware Insurance Code, the following recommendation will be made:

**It is recommended the Company promptly notify the Delaware Insurance Commissioner of any changes in its officers and directors as per the requirements of Section 4919 of the Delaware Insurance Code.**

Section 1304 of the Delaware Insurance Code requires that an insurer's Board of Directors approve investment transactions. A review of the Company's minutes noted that investment transactions for the last quarter of 2004 and all of 2005 were not approved by the Board, and that investment transactions for 2006 were not approved by the Board until April 30, 2007.

**It is recommended the Company comply with Section 1304 of the Delaware Insurance Code and have the Board of Directors approve investment transactions on a regular and timely basis.**

### **CORPORATE RECORDS**

GLIC's By-laws state that the business and affairs of the Company shall be managed by the Board of Directors. The examination noted that the Company's Board of Directors did not review or approve the financial statements of the Company. More importantly, changes in the federal banking laws in 2000 permitted banks to offer the debt protection product that was the main business that GLIC assumed. The changes in the federal banking laws basically placed the Company in run-off. The Company's Board of Directors did not discuss or address the changes in the federal banking laws.

**It is recommended that all important matters effecting GLIC, including financial results, be discussed and approved by the Board of Directors.**

The Company's By-laws also require GLIC to hold an annual shareholder meeting for the purpose of electing members of the Board of Directors. From the minutes supplied to the examiner, no shareholder meeting was held in 2005.

**It is recommended that the Company comply with the By-laws and hold annual shareholder meetings.**

### **GROWTH OF COMPANY**

The following information was reported by the Company on the respective filed annual statements:

<b>Year</b>	<b>Admitted Assets</b>	<b>Policyholders Surplus</b>	<b>Premium Earned</b>	<b>Net Income</b>
2003	\$63,259,290	\$53,596,545	58,940,572	\$19,617,420
2004	76,226,154	69,360,411	42,017,202	15,802,433
2005	94,246,548	82,349,454	31,965,285	13,027,423
2006	20,139,642	17,940,575	24,813,257	10,585,694

As indicated, the Company has continuously been profitable. As noted previously, in 2006 GLIC paid a shareholder dividend of \$75,000,000. Starting in 2000, banks began offering the debt protection product that was the main business that GLIC assumed. The Company has assumed no new business since 2000.

### **TERRITORY AND PLAN OF OPERATION**

The Company is licensed in three (3) states: Delaware, Ohio and South Carolina. The Company is also licensed for reinsurance only in Florida. In 1993, the Company began to assume credit unemployment and credit accident and health insurance from third party insurers for consumer credit insurance which originated with the Company's affiliated lending institutions.

The Company does not write insurance directly; all gross premiums originate from assumed reinsurance (see following section).

### **REINSURANCE**

All of the reinsurance assumed by GLIC pertains to credit card products generated by affiliated financial institutions of the J.P. Morgan Chase Banking Group. The insurance is underwritten directly by non-affiliated insurers who cede the business to the Company. GLIC does not cede reinsurance. Total assumed and net premiums written for 2006 were \$24,813,232.

As of the date of the 2003 examination, the Company had contracts with five ceding companies, and business remained unchanged during the period under examination. The five ceding insurers and the products written were:

<u>Direct writing insurer</u>	<u>Products</u>
American Bankers Insurance Company of Florida	Credit Involuntary Unemployment Insurance; Accidental Death
American Bankers Life Assurance Company	Involuntary Unemployment Insurance; Accidental Death
American Security Insurance Company	Involuntary Unemployment & Leave of Absence
Standard Guaranty Insurance Company	Involuntary Unemployment & Leave of Absence
Central States Indemnity Company of Omaha	Group Credit Unemployment

On December 1, 2003, the reinsurance contracts related to the credit card business with the Assurant Group (all the insurers ceding to the Company except Central States) were amended to cede only 90% of the subject business ( previously the cession was 100%.).

As noted previously, GLIC has assumed no new business from the above contracts since 2000.

## **INTERCOMPANY AGREEMENTS**

As of December 31, 2006, the Company had three Inter-company agreements in place:

### **J.P. Morgan Insurance Agency, Inc. (JPMIC)**

A Management Agreement was entered into as of October 1, 1996 by which JPMIC provides all the services, except investment management, necessary to operate the Company.

The Management Agreement states that JPMIC will be paid a flat monthly fee of \$50,000 for providing services. The previous examination noted that the monthly management fee was recalculated semi-annually, based on a cost-benefit analysis. It was suggested that the Management Agreement be amended to reflect the calculation of the monthly fee. For 2006, GLIC incurred management expenses of \$41,379.

The examination noted that the Management Agreement has not been amended to reflect the new procedure for calculating management fees.

**It is recommended the Company amend the Management Agreement with J.P. Morgan Insurance Agency to reflect the current calculation method for assessing management fees.**

### **J.P. Morgan Investment Management Inc.**

GLIC entered into an agreement with J.P. Morgan Investment Management, Inc. on February 11, 1997 to manage the Company's investment portfolio. Fees paid to the investment manager in 2006 were zero.

### **Tax Allocation Agreement**

The Company is included in the consolidated federal tax return of J.P. Morgan Chase and Co. as per an agreement entered into January 31, 2002.

**ACCOUNTS AND RECORDS**

The Company's accounts and records were audited during the examination period by PriceWaterhouseCoopers (PwC). Selected workpapers from PwC's 2006 audit files were obtained and utilized to the extent possible.

**FINANCIAL STATEMENTS**

The following statements show the Company's operations for 2006 and its financial condition, as of December 31, 2006, as determined by this examination:

**ASSETS**

	Ledger <u>Assets</u>	Assets not <u>Admitted</u>	Net Admitted <u>Assets</u>	NOTES
Bonds	\$3,963,526	\$1,643,160	\$2,320,366	1
Cash, Cash Equivalent and Short Term Investments	13,479,946		13,479,946	1
Investment Income D&A	38,578		38,578	
Funds Held by Reinsure	24,244		24,244	
Net Deferred Tax Asset	13,371	(769,943)	783,414	
Current Federal Income Tax Recoverable	178,665		178,665	
Receivable from Insurance Carriers	<u>2,454,683</u>	<u>595,167</u>	<u>1,859,516</u>	2
<b>TOTALS</b>	<u>\$20,153,113</u>	<u>\$1,468,384</u>	<u>\$18,684,729</u>	

**LIABILITIES, SURPLUS AND OTHER FUNDS**

		Notes
Losses	\$2,011,484	4
Loss Adjustment Expenses	7,861	
Other Expenses	81,000	
Taxes, Licenses and Fees	84,928	
Payable to parent, subsidiaries and affiliates	9,353	
Miscellaneous Liability	<u>4,441</u>	
Total Liabilities	2,199,067	
Common capital stock	1,000,000	
Gross paid in and cont. capital	1,500,000	
Unassigned funds (surplus)	<u>13,985,662</u>	
Surplus as Regards Policyholders	<u>16,485,662</u>	
TOTAL	<u>\$18,684,729</u>	

**STATEMENT OF INCOME**

Premiums earned	\$24,813,257
Losses Incurred	1,351,132
Loss expense incurred	111,480
Other Under writing expenses incurred	<u>9,506,063</u>
Total Under Writing Deductions	10,968,675
Net investment income earned	4,037,621
Net realized capital gains (losses)	<u>(1,568,925)</u>
Net investment gain	2,468,696
Aggregate Write-ins for Misc. Income	1,480
Net income before dividends to policyholders and Federal income taxes	16,314,758
Federal income taxes incurred	<u>5,729,064</u>
NET INCOME	<u>10,585,694</u>

**CAPITAL AND SURPLUS ACCOUNT**

Surplus as Regards Policyholders, December 31, 2005	\$82,349,454
Net Income	10,585,694
Change in net deferred income tax	18,898
Change in nonadmitted assets	(1,468,384)
Dividends to stockholders	(75,000,000)
Net change in Surplus as Regards Policyholders	<u>\$(65,863,792)</u>
Surplus as Regards Policyholders, December 31, 2006	<u>\$ 16,485,662</u>

**SCHEDULE OF EXAMINATION CHANGES**

	<u>Company Amount</u>	<u>Examination Amount</u>	<u>Increase/(Decrease) To Policyholder Surplus</u>
<b><u>Asset</u></b>			
Bonds	\$3,963,526	\$2,320,366	(\$1,643,160)
Receivable from Insurance Carriers	2,454,683	1,859,516	(595,167)
Net Deferred tax Asset	0	783,414	<u>783,414</u>
Total Examination Adjustment			(\$1,454,913)
GLIC Reported Surplus as Regards Policyholders			<u>17,940,575</u>
Examination Surplus as Regards Policyholders			\$16,485,662

**NOTES TO FINANCIAL STATEMENTS****Note 1. – Invested Assets: Bonds, Cash Equivalents and Short-Term Investments**

In the Reinsurance Section of this report, it was noted that GLIC assumed premiums from various ceding insurers. As part of the reinsurance process, GLIC maintained bank accounts for the benefit of the ceding party. A review of the custody accounts show that the ceding company has access to the accounts in priority to the Company, and that GLIC has to maintain funds in the

accounts equal to the reserves. The examination compared the balances in the accounts to the reserves.

GLIC has \$3,100,777 on deposit in three bank accounts for the benefit of the Assurant Group. The reserves assumed from Assurant were \$1,987,240 at year end 2006. The examination will non-admit the difference of \$1,113,537.

GLIC has \$529,623 on deposit at Key Bank for the benefit of Union Fidelity. The Company carries no reserves for Union Fidelity and hasn't assumed business from that insurer in approximately five years. The entire amount on deposit of \$529,623 is non-admitted.

Total invested assets non-admitted are \$1,643,160. In the interest of clarity, the entire adjustment will be made to the Bond account in the financial statements of this report.

#### **Note 2. Receivable from Insurance Carriers**

For year end 2006, GLIC adopted a new procedure for reporting premiums. In previous years, the Company reported assumptions using a 1.5 month lag in receiving information from the ceding insurers. For December 31, 2006, GLIC estimated premiums for November and December, 2006, and the estimate was the basis for the above stated receivable.

Based on a review of the actual premiums for November and December, 2006, the Company's estimate was overstated by \$595,167. The financial statements of this examination have been adjusted to reflect the actual premiums reported.

#### **Note #3 Net Deferred Tax Asset**

The examination has accrued an amount of \$783,414 to reflect the 35% tax effect on the two examination financial adjustments noted above. Though the tax adjustment could affect both

current and deferred taxes, in the interest of clarity, the total amount is accrued in the Deferred Tax Asset annual statement item.

**Note #4 Losses and Loss Adjustment Expenses**

The examination reviewed the report of Milliman, the Company's actuarial consultants, and also reviewed the analysis prepared by PriceWaterhouseCoopers, GLIC's auditing firm. Based on these reviews, the Company's reported amounts for Losses, \$2,011,484 and Loss Adjustment Expenses, \$7,861, are accepted for purposes of this report.

**SUBSEQUENT EVENTS**

While the examination was in progress, Company management informed the Delaware Insurance Department of the intention to merge GLIC into a Vermont-domiciled captive of the J.P. Morgan Chase & Co. Management indicated that said merger would likely occur before year end 2007.

**STATUS OF PRIOR EXAMINATION RECOMMENDATIONS**

The 2003 examination made two recommendations. One of the recommendations, as per compliance with Section 4919 of the Delaware Insurance Code, is repeated by this examination.

**RECOMMENDATIONS**

The Company's attention is directed to the following:

It is recommended the Company take greater care in reporting officers and directors on the Company's filed financial statements. (See Management and Control, page 6).

It is again recommended that the Company promptly notify the Delaware Insurance Commissioner of any changes in its officers and directors the Company as per the requirements of Section 4919 of the Delaware Insurance Code. (See Management and Control, page. 7)

It is recommended the Company comply with Section 1304 of the Delaware Insurance Code and have the Board of Directors approve investment transactions on a regular and timely basis. (See Management and Control, page 7).

It is recommended that all important matters effecting GLIC, including financial results, be discussed and approved by the Board of Directors. (See Corporate Records, page 7).

It is recommended that the Company comply with the By-laws and hold annual shareholder meetings. (See Corporate Records, page 8).

It is recommended the Company amend the Management Agreement with J.P.Morgan Insurance Agency to reflect the current calculation method for assessing management fees. (See Inter-Company Agreements, page 10).

### **SUMMARY COMMENTS**

The following significant events were noted by the examination:

- GLIC is a subsidiary of J.P.Morgan Chase & Co., one of the largest financial services firms in the world.
- All of the reinsurance assumed by GLIC pertains to credit card products generated by affiliated financial institutions of the J.P. Morgan Chase Banking Group.
- The Company has continually been profitable and generated \$39,415,550 in Net Income during the three year examination period.
- In 2000, changes in the federal banking laws permitted banks to begin offering a debt protection product that was the main business that GLIC assumed.

Since 2000, the Company has assumed no new business.

- In 2006, GLIC received permission from the Delaware Insurance Department to pay a \$75,000,000 shareholder dividend.
- While the examination was in progress, Company management informed the Delaware Insurance Department of the intention to merge GLIC into a Vermont-domiciled captive of J.P. Morgan Chase & Co.

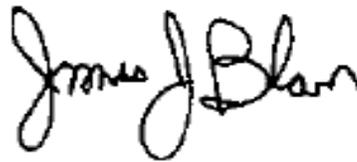
### **CONCLUSION**

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

Description	Current Examination	12/31/2003 Examination	Increase (Decrease)
Assets	\$18,684,729	\$63,259,290	(\$44,574,561)
Liabilities	2,199,067	9,662,745	(7,463,678)
Surplus as Regards Policyholders	16,485,662	53,596,545	(37,110,883)

The examination was conducted by the undersigned.

Respectfully submitted,



James J. Blair Jr. CFE, CPA  
Examination Supervisor  
Department of Insurance  
State of Delaware